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SUBJECT: IMF SAYS GVN ECONOMY NOT OUT OF THE WOODS

HANOI 00001095 001.2 OF 002

¶1. (SBU) Summary: An IMF team concluded its twelve-day assessment of Vietnam's macroeconomic situation and briefed the Hanoi donor community on September 16, 2008. While a number of economic indicators including the current account balance have improved, core inflation remains high and the banking system is under stress from non-performing loans. The team encouraged the Government of Vietnam (GVN) to retain a tight monetary and fiscal policy and improve its capacity to track and report economic data. The assessment came prior to the most recent round of U.S. financial turmoil, so as the team concluded its briefing the GVN was scrambling to deal with the new wave of macroeconomic uncertainty. Another IMF team will return in December for Article IV consultations. End Summary.

Current State of the Economy

¶2. (SBU) Following a twelve-day evaluation, the IMF team tasked with assessing Vietnam's macroeconomic situation reported to the donor community on September 16. The team began by outlining recent improvements in a number of economic indicators. The current account balance has improved and is hovering at around 13.5 percent of GDP, down from as high as 20 percent in 2Q08. The team leader noted that the Vietnamese dong (VND) has stabilized and is now trading in the middle of the trading range without government intervention. (Note: An article in the Vietnamese press that same day indicated that the State Bank of Vietnam has started to intervene again, raising the average interbank exchange rate to VND16,512/US$1 and buying dollars.) The trade deficit, though still significant, is trending down from its peak in March and April of this year.

¶3. (SBU) The team cautioned that while overall inflation has peaked, core inflation (overall inflation minus food, fuel and administratively controlled prices) has not. The team attributes this to second-round effects of the initial inflation spurt, as workers receive wage increases and prices are raised correspondingly. The IMF Resident Representative noted that while recent surveys put wage increases at around 18-20 percent, anecdotal evidence provides a number closer to 30 percent. (Note: The GVN is already planning a civil service pay increase and a 15 percent increase in pensions, effective October 1, and a change to the minimum wage law set for January 1, 2009.) The team was also unable to determine if overall government spending is declining; while it appears that was the case for the first half of 2008, GVN projections for the second half of the year show a significant increase in expenditures. It was not clear whether this was the actual intent of the GVN or just the result of weak forecasting skills at the Ministry of Finance.

¶4. (SBU) The team also noted the continued strains on the banking system, where data is extremely scarce. High credit growth in 2007 combined with heavy investment in the now-declining property market means that there will likely be a significant jump in non-performing loans by the end of this year. The Resident Representative added that depositors will not return to the banks until inflationary expectations are brought down by sustained GVN commitment to tight monetary and fiscal policy. (Note: The current interest rate cap of 21 percent has deposit rates at around 18 percent, still under year-on-year inflation of 28 percent, so people are reluctant to place their assets in the banking system.) The IMF team did receive assurance from the SBV that the base rate will remain stable through
¶2008. (Note: Recent statements in the press by mid-level SBV officials indicate, however, that the base rate and/or reserve requirements may be adjusted following the release of September or third quarter inflation figures. Our contacts at the SBV claim this is not that case and that the tight liquidity situation will be maintained through the end of the year.)

Outlook Improving, but Inflation Persists

¶5. (SBU) Assuming there is no change in interest rates and fiscal policy, the IMF believes that the economic situation in Vietnam will improve, but only gradually. The team forecasts GDP growth of 6 percent in 2008 and 2009 and overall inflation at 15 percent in
¶2009. Core inflation (which excludes fuel, food, and administratively controlled prices), however, will stay above 20 percent in 2009 as food and fuel prices will fall by more than other prices. The current account deficit will decrease to around 10.5 percent of GDP and reserves will rise modestly as long as there is not a significant decrease in FDI and remittances.

IMF Recommends Continued Tightening, More Transparency

HANOI 00001095 002.2 OF 002

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¶6. (SBU) The team also made a number of recommendations to GVN policy makers. Along with controlling inflation expectations, the IMF feels that the base rate should be raised by 2 percent. The team also recommended that the GVN contain fiscal spending and reduce the budget deficit in 2009. They noted that the recent elimination of fuel subsidies will help in this regard. Spending by state owned enterprises (SOEs) should continue to be tightly supervised, and the equitization process accelerated. Bank supervision should be improved and legal reform implemented to strengthen the independence of the SBV. Finally, the team recommended that data provisioning and communications be improved, but also noted that the SBV will be launching and English language website and recently began supplying the IMF with updated macroeconomic data (available on the IMF Resident Representative web site, http://www.imf.org/external/country/VNM/rr/in dex.htm).

¶7. (SBU) Comment: The GVN is facing real pressure, from both internal sources such as pro-growth ministries like the Ministry of Planning and Investment and external sources such as businesses who want easier access to credit, to shift from an anti-inflationary policy to a policy that supports rapid economic growth. In addition, Vietnam still faces risks from a global slowdown, as its balance of payments is heavily dependent on FDI and exports. The newly-empowered State Bank of Vietnam (SBV) will have to stand firm in its commitment to a tighter monetary policy in the face of mixed messages about fiscal policy from the Ministry of Finance. End Comment.

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